UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re

WILLIAM GARRETH MOORE
TAMELA A. MOORE,

Debtors.

Case No. 02-10127-DHW
Chapter 7

SOUTHTRUST BANK,

Plaintiff,

v.

WILLIAM GARRETH MOORE,

Defendant.

Adv. Proc. No. 02-1038-DHW

MICHAEL K. McCARTHY and
GAIL A. McCARTHY,

Plaintiffs,

v.

WILLIAM GARRETH MOORE,

Defendant.

Adv. Proc. No. 02-1037-DHW

MEMORANDUM DECISION

SouthTrust Bank and Michael and Gail McCarthy commenced the above-styled adversary proceedings under 11 U.S.C. § 523(a)(2), (4), and (6) to determine the dischargeability of their claims against William Garreth

Moore.[1] The claims arise from their dealings with Moore in connection with his residential construction business.

The two proceedings were consolidated for trial. The three-day trial was held in February 2004. Both sides presented testimonial and documentary evidence. SouthTrust Bank and the McCarthys were represented by counsel; Moore represented himself.

The parties requested time to file post-trial briefs. SouthTrust Bank and the McCarthys filed timely briefs; Moore filed none.

Upon consideration of the evidence adduced at trial and the arguments of counsel, the court makes the following findings of facts and conclusions of law.

Jurisdiction

The court has jurisdiction of this proceeding pursuant to 28 U.S.C. § 1334 and the general order of reference of title 11 matters by the United States District Court for this district. Because this is a core proceeding under 28 U.S.C. § 157(b)(2)(I), jurisdiction extends to the entry of a final judgment.

Findings of Fact

William Garreth Moore worked in the construction industry for almost 30 years. He started working for his father's construction business

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[1] The McCarthys filed the complaint initially under only § 523(a)(2) and (a)(6). At trial, the McCarthys moved to amend the complaint to include a claim under § 523(a)(4). The motion was granted under Fed. R. Bankr. Proc. 7015(b) which allows amendments conforming to the evidence adduced at trial. The amendment relates back to the date of the original complaint under Rule 7015(c) because it "arose out of the conduct, transaction, or occurrence set forth . . . in the original pleading." Fed. R. Bankr. Proc. 7015(c). However, the ruling of the court renders consideration of the claim under § 523(a)(4) unnecessary.

in high school. When his father retired in 1977, Moore took over his father's business.

Moore soon began to build homes as Moore Construction Company, a sole proprietorship. He built both "spec" homes and "pre-sold" homes. He has built scores of homes over the last 20 years. In the last 6 to 8 years, he has built homes primarily in the $150,000 to $200,000 range.

Moore developed an excellent reputation as a builder. He was licensed by both the City of Enterprise and the Alabama Homebuilder's Licensure Board.

However, he allowed his state license to expire on December 31, 2000. Renewal of the license would have required at least some amount of financial disclosure.[2] Moore testified that it was cost efficient to expire the license periodically because of the low reinstatement fee. However, there is no evidence that reinstatement would be retroactive. Failure to be licensed could subject him to fines and penalties by statute.

SouthTrust Bank

SouthTrust Bank began making loans to Moore in 1986. From 1986 to 2001, the bank made a total of 40 loans. Of those, ten were made between April 1986 and July 1988. Not all of the 10 were construction loans; several were unsecured. The remaining 30 were made from April 1995 forward.

34 of the 40 loans were repaid as agreed. The face amount of the 34 loans totals about $2.5 million. Of the six problem loans, one was satisfied through foreclosure and resulted in no loss to SouthTrust Bank.

The remaining five have not been paid. Two of the five are

[2] Moore denied that the disclosure requirements dissuaded him from renewing his license.

unsecured. The remaining three are construction loans made for the purpose of building homes on specific lots.

SouthTrust generally loaned 80% of the appraised post-construction value of the real property. The appraisal was based on detailed plans of the residence to be constructed.

Typically, the first draw under each loan was intended to fund the purchase of the lot. To obtain subsequent draws, Moore telephoned a request to the loan officer's secretary. The secretary told Moore the undrawn amounts of the various pending loans. Moore told the secretary to which lot to apply the draw. He usually chose the lot with the largest undrawn amount. He then picked up the check at a drive-through window.

Lot 20C

The first problem loan was made on August 11, 1999 in the amount of $147,008.65. The loan was made for the purpose of building a spec house on Lot 20, Block C, in Creek Pointe Subdivision, Enterprise, Alabama. The following chart reflects the major draws on the loan:[3]

Aug. 11, 1999	$45,000
Aug. 31, 1999	$28,000
Sept. 21, 1999	$20,000
Oct. 18, 1999	$18,000
Nov. 22, 1999	$15,000
Jan. 24, 2000	$15,000
Feb. 14, 2000	$5,000

[3] The draws total only $146,000, but the parties concede the loan was fully funded.

Therefore, Moore took draws on the loan almost monthly, and the loan was fully funded within 6 months. The loan was last renewed in November 2000. Moore never completed the house.

By May 2001, almost 2 years after the loan was made, the house was only 80 to 85% complete. Charlene Goolsby and her husband expressed an interest in purchasing the incomplete house on behalf of their son, Jeff Goolsby.

The Goolsbys owned a plumbing and electric business and had done work for Moore in conjunction with his construction business. Moore owed the Goolsbys about $44,400 for work done on 10 projects, including Lot 20C. Moore stayed past due in their relationship. However, his account had become more delinquent than usual by the end of 2000.[4]

The Goolsbys agreed to purchase the house from Moore for $138,907. The proposed purchase price included a credit for a portion of Moore's debt to the Goolsbys. Moore testified that he needed to come up with an additional $20,000 to pay off the SouthTrust note. SouthTrust did not give the debtor permission to transfer the property without releasing the lien of SouthTrust. The Goolsbys hoped to close the purchase at the end of August 2001.

The Goolsbys continued to perform plumbing and electrical work for Moore. Moore led them to believe that they would be paid for this work.

Jeff Goolsby took possession of the property on Labor Day 2001 without the knowledge of SouthTrust Bank and without closing the purchase. The Goolsbys made requests of Moore to close the purchase.

In December 2001, Moore told Charlene Goolsby that he was working out an arrangement with SouthTrust Bank so he could close the

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[4] Moore ran outstanding balances with most of his vendors for 20 years. At the time of filing bankruptcy, Moore owed approximately $358,000 to his trade creditors.

purchase. In addition to the SouthTrust mortgage, there was an Internal Revenue Service lien on the property.

Moore was unable to come up with the additional money to payoff the bank's mortgage and the tax lien. Moore filed a chapter 7 petition on January 18, 2002. SouthTrust Bank foreclosed Moore's interest in the property on April 30, 2002.

The Goolsbys purchased the property from SouthTrust at foreclosure for $168,606.92 (about $30,000 above their agreement with Moore). They then expended an additional $14,000 to complete the house. The SouthTrust note was satisfied in full through foreclosure.

Lot 21C

The second problem loan was made on December 2, 1999 in the amount of $140,567.90. The loan was made for the purpose of building a spec house on Lot 21, Block C, in Creek Pointe Subdivision, Enterprise Alabama. The following chart reflects the major draws on the loan:

Dec. 2, 1999	$42,000
Dec. 20, 1999	$33,000
Jan. 10, 2000	$28,000
Jan. 24, 2000	$6,600
Feb. 2, 2000	$18,000
Feb. 14, 2000	$5,000
Jan. 5, 2001	$7,000

With the exception of the last draw, the loan was fully funded within 2½ months. The loan was renewed on January 5, 2001. Moore neither cleared the lot nor commenced construction.

SouthTrust sold the unimproved lot following foreclosure in April 2002 for around $37,500.[5]

Two Signature Loans

The next problem loans were made on March 6, 2000 and July 28, 2000 in the respective amounts of $21,982.58 and $73,269.11. The notes on their face are not secured. The bank contends that future advance clauses in other mortgages effectively secure the loans. The notes require a single payment and mature at the end of one year.

The $21,982.58 note is signed by the debtor as an individual. The $73,269.11 note is signed by the debtor as president of Moore Construction. The fine print on each note requires Moore to use the proceeds solely for business purposes.

According to SouthTrust, the $73,269.11 loan was a refinanced combination of two previous loans. The three original loans were made to enable the debtor to buy lots to construct houses. However, the bank has no records reflecting whether Moore actually used the money to buy lots.

Moore testified that both signature notes were refinanced not once but several times. The practice had been for Moore to pay 5 to 10% of the principal balance plus interest as a condition of refinancing. A new note would then be executed. He did not recall the purpose for the original notes. Moore stated that over time the principal had been reduced by as

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[5] There is some dispute whether the initial draw functioned as a "lot draw" to enable the debtor to purchase the lot. Moore testified that he "guesses" he used the initial draw in the amount of $42,000 to pay for the lot. The bank contends that the initial draw was unnecessary because he already owned the lot.

The title documents reflect that Moore already owned the lot on the date of the loan. This information would have been available to the bank at the time the loan was made. However, the bank's draw sheet for the loan reflects the initial draw as a "lot draw."

much as $60,000.

Lot 28

The next problem loan was made on March 20, 2000 in the amount of $132,575.90. The loan was made for the purpose of building a spec house on Lot 28, Huntington Drive, Enterprise, Alabama. The following chart reflects the major draws on the loan:[6]

March 20, 2000	$36,000
April 18, 2000	$28,000
May 30, 2000	$20,000
July 18, 2000	$18,000
August 24, 2000	$24,000
Oct. 2, 2000	$5,600

Moore took draws on the loan almost monthly, and the loan was fully funded in less than 7 months. The loan was renewed in March 2001. Moore commenced but never completed construction of the house.

In February 2001, Kelly Yoakum and her husband contracted with Moore to purchase Lot 28. At that time, the house consisted merely of a concrete slab with some plumbing pipes attached. No framing had been erected. Moore agreed to complete the house by the end of May or the first of June.

When the Yoakums moved to Enterprise at the end of May, the house was not complete. Moore arranged for the debtors to stay in some temporary housing and stated the house would be completed in about 3

[6] The draws total only $131,600, but the parties concede the loan was fully funded.

weeks.

By the end of August, the house was still not complete, and the Yoakums decided they could wait no longer. They notified Moore of their decision to withdraw from the contract.

On September 14, 2001, Moore provided SouthTrust Bank with a copy of the contract with the Yoakums in an effort to support his ability to repay the outstanding loans to SouthTrust. However, the Yoakums had already withdrawn from the contract by that date.

The house was about 85% complete when Moore filed the chapter 7 petition on January 18, 2002 (according to the schedules). SouthTrust Bank foreclosed Moore's interest in the property on April 30, 2002 and subsequently sold the property for a loss.

Lot 4C

In the mid to late 1990s, Moore and his brother formed Moore Development Company, L.L.C. to develop a subdivision called Cotton Creek Plantation. Moore owned a one-third interest, and his brother owned the remaining two-thirds interest. Moore managed the L.L.C. on a day-to-day basis and signed all of the checks.

Community Bank & Trust financed the purchase of the land and held a first mortgage on the subdivision. Moore and his brother guaranteed the loan for Moore Development Company, L.L.C. The subdivision comprises 211 acres, and Phase I is divided into 80 lots. Moore Construction obtained a construction loan from SouthTrust Bank to build a house on one of the lots.

The SouthTrust loan was made on January 26, 2001 in the amount of $186,988. The loan was made for the purpose of building a spec house on Lot 4, Block C, Cotton Creek Boulevard, Enterprise, Alabama. The following chart reflects the major draws on the loan:

Jan. 26, 2001	$45,000
Feb. 12, 2001	$28,000
Feb. 26, 2001	$25,000
Mar. 12, 2001	$28,000
Mar. 23, 2001	$18,000
Apr. 6, 2001	$26,000
Apr. 20, 2001	$10,000

Therefore, Moore took draws on the loan almost twice monthly, and the loan was fully funded within 3 months.

Moore did not use the initial draw to obtain a release of the underlying mortgage held by Community Bank & Trust. The draw sheet for that loan indicates that the initial draw was a "lot" draw. The house was approximately 50% complete when he filed chapter 7 on January 18, 2002 (according to Moore's schedules).[7]

SouthTrust Bank foreclosed Moore's interest in Lot 4C on April 30, 2002. Community Bank & Trust had a superior lien on the property at that time. SouthTrust Bank negotiated with Community Bank & Trust to release its lien for $29,000. At some point, Community Bank & Trust foreclosed the L.L.C.'s interest in the subdivision.

More Findings of Fact

With the exception of the two signature notes referenced above, all of the pertinent loan documents contained similar language.

In the construction loan documents, Moore covenants to use the

[7] An officer of SouthTrust Bank inspected the property around September 2001 and concluded that the property was 40 to 50% complete.

proceeds of each loan solely to construct a house on the specified lot, to commence construction within 30 days of the loan, and to diligently pursue construction to completion by the specified date. He covenants to "keep and maintain proper and accurate books, records and accounts reflecting all items of income and expense . . . in connection with the project." Moore covenants to "preserve and keep in full force and effect [his] business and make sure [he] complies with all laws applicable to it." He warrants that he "possesses all licenses, permits and approvals that are required for ownership and operation of [his] business." He warrants that he has paid all taxes that have become due. He further warrants that he is the owner of the subject real estate free and clear from all but excepted encumbrances.

In addition, each request for a draw under the loan "constitutes an affirmation that the representations and warranties . . . remain true and correct." The disbursement of proceeds under the loan does not constitute any waiver by the bank.

Moore dealt with Paul Dykes, Senior Vice-President at SouthTrust Bank in Enterprise, Alabama on all of the loans in question. Dykes had done business with Moore for years both at SouthTrust and as a lending officer at a savings and loan association. Dykes left the savings and loan association and began working for SouthTrust in 1995. He managed two bank offices and policed loans.

Dykes had made numerous loans to Moore at the savings and loan association prior to his employment with SouthTrust. He did not consider Moore a high risk based on the long history of loans made and paid. He considered him a good customer at each location. Dykes had never had a problem with Moore. He trusted Moore and expected him to disclose financial problems as required by the contracts. They were in the same Sunday School class.

Dykes did not inspect the properties on which Moore had construction loans. Dykes spent his time monitoring loans he deemed a

higher risk. He was unaware that Moore's license had lapsed or that Moore had unpaid tax obligations or that Moore was using the proceeds of the loans for unauthorized purposes. In addition, Moore failed to keep the requisite books and records allocating application of the loan proceeds to the various projects or alert the bank of his defaults.

Had Dykes known of these problems, he would have talked with his supervisor and Moore to see if the problems could be solved. A default under one SouthTrust loan constituted a default under each of the SouthTrust loans.

In March or April 2001, SouthTrust Bank called the two signature loans and refused to make any more construction loans to Moore.

After the loans were downgraded as "problem loans," Mike Carter, Vice-President of Market Special Assets, undertook in August 2001 to evaluate the loans. Carter attempted to work with Moore to see if the loans could be rehabilitated. Carter more than likely would have immediately called the loans had he known that Moore had violated covenants in the construction loan agreements. Carter did not know that Moore's license had lapsed or that he had outstanding withholding tax liability. Carter had learned, however, of the tax lien against Lot 20C (the Goolsby lot).

In September or October 2001, Moore told Carter that he had a contract on Lot 28C with the Yoakums and that, upon completion of the swimming pool and fence, the sale would close.[8] The bank relied on Moore's representation in continuing to forbear. However, as stated above, the Yoakums had already withdrawn from the contract, and the house was not more than 85% complete.

In addition, Moore represented to the bank that he had a contract on Lot 20C with the Goolsbys and had already received $40,000 toward the

[8] As stated above, Moore provided a copy of the contract to SouthTrust Bank. The contract with the Yoakums required construction of a swimming pool and fence.

purchase price. In fact, Moore had not received any cash from the Goolsbys.[9]

Moore wrote a letter to Carter in October 2001 outlining his plan to resolve his financial problems. Moore referenced "an available credit line at The Peoples Bank in Elba to build two speculative houses." However, Doris Matthews, President of People's Bank, testified that, though Moore had previously had a credit line with the bank, in the last 2 or 3 years the bank had usually dealt with him on a case-by-case basis. She was unsure whether the credit line had been renewed because the bank's records had been destroyed in a flood. However, there is no evidence that Moore drew on this credit line, if it existed, in an effort to work out his financial problems with SouthTrust Bank.

On December 5, 2001, Carter sent Moore a proposed forbearance agreement. Moore did not sign the agreement but responded that he was trying to obtain another loan from People's Bank by offering a mortgage on his mother's home to enable him to complete the houses he was building.

At that time there were three mortgages on his mother's home. SouthTrust Bank held a mortgage dated November 1988 which had been paid.[10] Moore's brother held a second mortgage in the face amount of $68,000. SouthTrust Bank held a third mortgage dated December 1996. The third mortgage was not paid until December 11, 2001. SouthTrust Bank refused to release the third mortgage because the property also secured other loans with the bank. SouthTrust did not foreclose the mortgage because of the superior second mortgage held by Moore's brother.[11] The parties stipulate that the house was worth $114,000 as of

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[9] The purchase price reflected a credit for money owed by Moore to the Goolsbys. However, the purchase price had not been paid.

[10] The mortgage was paid in December 1996.

[11] Moore introduced into evidence a mortgage release from his brother dated December 10, 2001. The document contains no stamp reflecting recordation. Mike

November 2001.

Moore Development Company, L.L.C. defaulted on the subdivision loan owed to Community Bank & Trust during the first part of 2002. When Community Bank & Trust commenced the foreclosure process, it learned that five of the subdivision lots had been sold without remission of the proceeds to the bank. Three of the lots were sold to individuals other than Moore, and two were sold to Moore. One of the two held by Moore was Lot 4C addressed above.

The purchasers were very upset at the prospect of foreclosure because they had paid for their lots. One of the purchasers threatened to sue the bank. One of the purchasers had already constructed a house on the lot. Upon the agreement by Moore and his brother to release their right to redeem the lots, Community Bank & Trust excluded from foreclosure the three lots sold to the non-Moore purchasers. Community Bank & Trust sustained a substantial loss on the subdivision loan.[12]

SouthTrust submitted an exhibit outlining its losses on the above loans. The loss, not including a contractual 15% attorney's fee, totals

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Carter testified that he had never seen or heard of the document's existence.

[12] Moore stated that the construction loan agreement contemplated the development of only 76 lots in the subdivision. However, 80 lots were in fact developed. Moore argues that because the Bank gained 4 lots but lost only 3, it was a breakeven for the Bank. However, this argument ignores that the Bank had a mortgage on the entire subdivision no matter how many lots were constructed within its borders.

In addition, an officer of the Bank testified that the final plat contemplated 80 lots. The bank's records reflect a mortgage release price on only 77 lots. However, the reason there is a release price of only $3,000 on one lot was solely to accommodate Moore. The Bank asked for Moore's input in determining the release price on the other 3 lots, but Moore did not respond, and the release price remained blank on those remaining lots.

$405,067.41.[13]

The McCarthy Contract

Michael and Gail McCarthy moved to Alabama with their two children in June 2000 and leased a home. In February 2001, they purchased a lot in Creek Pointe Subdivision, Enterprise, Alabama for $32,500 and began to look for a home builder.

They contacted Moore in March 2001. On June 14, 2001, they signed a contract with Moore for the construction of their home. The McCarthys chose Moore because of the quality of his work and his reputation as a builder.

Moore gave the McCarthys the option of obtaining their own construction financing or conveying the lot to Moore for him to obtain the construction financing. The McCarthys chose the latter option and executed a deed of their lot to Moore. They received no cash and did not reserve a mortgage.

The contract required Moore to construct the home by September 15, 2001 for the price of $163,000. The price did not include the value of the lot. The contract contemplated reconveyance of the improved lot to the McCarthys upon completion of construction.

The completion date was important to the McCarthys. Gail McCarthy had continuing complications from open heart surgery the previous November. The McCarthys needed an extra room to accommodate visiting parents. In addition, the lease on their rental home was scheduled to expire around September.

Moore obtained a construction loan from The Peoples Bank of Coffee

[13] This loss figure may not take into account the value of the interest, if any, held by SouthTrust Bank in Moore's mother's home.

County, Elba, Alabama on June 14, 2001 in the amount of $157,134.80. Moore was a long-time customer of The Peoples Bank. The bank had made between 120 and 150 loans to Moore in the past. Moore's mother was a former employee of the bank. Doris Matthews, President and CEO, testified that she had known Moore since he was a young man. He had always kept his word.

To secure the loan, Moore gave Peoples Bank a mortgage on the McCarthy lot. Moore did not disclose the existence of the McCarthys to Peoples Bank at that time. Moore made the following draws on the loan:

June 19, 2001	$58,000
June 28, 2001	$36,000
July 16, 2001	$24,000
August 2, 2001	$26,000
October 16, 2001	$12,600

With the exception of the last draw, the loan was funded in less than 2 months.

Moore did not do any work on the lot during the month of June. In July, he began clearing the lot and commenced foundation work. Concerned over the progress of the work, Michael McCarthy contacted Moore regularly.

In August, Moore completed the foundation, poured the slab and commenced framing. The framing was completed during the first part of September.

With the September deadline looming, McCarthy approached Moore and asked to repurchase the property in order to find someone else to complete the project. Moore requested additional time to finish the house and attributed the delay to his insistence on using quality subcontractors.

By the first of October, the house had been roughed-in and was awaiting a roof. McCarthy continued to contact Moore, but Moore was becoming increasingly difficult to reach. Moore blamed the delay on his mother's worsening illness. Moore completed the roof during the beginning of October. From a financial standpoint, the house was only around 40% complete though the loan had been fully drawn.[14] Moore did no further work on the property.

In November 2001, Moore went to Peoples Bank and told the president there had been some changes and that he needed additional money to build a fence and pool on the McCarthy lot. Moore represented that the house was otherwise complete. However, the McCarthys had not made any such request of Moore.

The bank sent an officer to inspect the property before authorizing the additional money. President Matthews was "shocked" to learn that the house was not complete. She had never had a problem with Moore and trusted him. She had been doing business with him for years and felt Moore had taken advantage of her trust.

Moore stated that he had gotten behind and used the loan for the McCarthy lot on other projects. The bank denied Moore's request for additional money to finish the house and asked Moore to better secure the bank's position.[15] Moore requested an additional loan secured by equipment or a mortgage on his mother's home. People's Bank declined the request.

In the beginning of January, Moore told McCarthy he was having

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[14] According to Moore's schedules, the house was 60% complete.

[15] Moore had obtained an unsecured 30-day loan from People's Bank in September 2001 in the amount of $25,040 to enable him to pay some tax obligations. The loan was renewed in November 2001. The bank eventually wrote off this loan as well as the loan for the McCarthy property.

some financial trouble but that the McCarthys would not get hurt. The McCarthys learned that the loan had gone into default. The next week Moore told McCarthy that he "should have protected" himself. Moore stated that he was considering bankruptcy but was working with SouthTrust Bank to "pull through this."

On January 17, 2002, Moore gave the McCarthys a second mortgage on their home in an effort to "protect them." He filed the chapter 7 case on January 18, 2002.

In June 2002, Peoples Bank foreclosed Moore's interest in the property for a loss. The McCarthys appeared at the foreclosure sale and bid on the property. However, Lee Phillips, a local homebuilder, outbid the McCarthys and purchased the property $110,000. Mrs. McCarthy was distraught at the loss of their dream home. When Phillips learned of the McCarthys' misfortune, he resold the property to them for $110,000.

The McCarthys paid an additional $139,032.89 to complete the house according to contract with Moore. Therefore the McCarthys paid $110,000 plus $139,032.89 (a total of $249,032.89) in order to obtain the house they had contracted to obtain for $163,000.[16]

Statement of Law
Section 523(a)(2)(A)

11 U.S.C. § 523(a)(2)(A) excepts from discharge any debt for money

[16] McCarthy testified that when he completed the house, he made some upgrades not included in his contract with Moore. According to the exhibit submitted by McCarthy, the $139,032.89 does not include the additional costs of the upgrades.

Moore introduced evidence to show that the value of the lot had increased over time thereby mitigating the loss to the McCarthys. However, the increase in the lot value did not reduce the costs required to complete construction. An increase in the lot value is part of the initial benefit for which the McCarthys bargained in purchasing the lot.

or property obtained by "false pretenses, a false representation, or actual fraud."[17]

An exception to discharge is to be strictly construed, and the creditor bears the burden of proving the exception. *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577, 1579 (11th Cir. 1986). Exceptions are construed strictly to give effect to the fresh start policy of the Bankruptcy Code. *Hope v. Walker (In re Walker)*, 48 F.3d 1161, 1164-65 (11th Cir. 1995). The creditor must prove each of the elements by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991).

To prevail on a claim under § 523(a)(2)(A), the creditor must prove that (1) the debtor made a false representation[18] with intent to deceive the creditor, (2) the creditor relied on the representation, (3) the reliance was justified, and (4) the creditor sustained loss as a result of the representation. *City Bank & Trust Co. v. Vann (In re Vann)*, 67 F.3d 277, 281 (11th Cir. 1995); *SEC v. Bilzerian (In re Bilzerian)*, 153 F.3d 1278, 1281

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[17] The section provides in relevant part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. § 523(a)(2)(A).

[18] SouthTrust Bank and the McCarthys contend that 11 U.S.C. § 523(a)(2) should not be limited to misrepresentations but should be interpreted broadly to embrace "all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated." *See McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000). However, the court can find no Eleventh Circuit authority supporting such an expansive interpretation of 11 U.S.C. § 523(a)(2). Nor would such an interpretation change the result in this proceeding.

(11th Cir. 1998); *Fuller v. Johannessen (In re Johannessen)*, 76 F.3d 347, 350 (11th Cir. 1996).

Justifiable Reliance

Justifiable reliance, rather than the more stringent reasonable reliance or the more lenient actual reliance, is the standard in § 523(a)(2)(A) litigation. *Field v. Mans*, 516 U.S. 59, 116 S. Ct. 437, 133 L. Ed. 2d 351 (1995); *City Bank & Trust Co. v. Vann (In re Vann)*, 67 F.3d 277, 281 (11th Cir. 1995).

Reasonable reliance is an objective test requiring conduct consistent with the standard of the reasonable man.[19] Justification, on the other hand, "is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." *Mans,* 516 U.S. at 71 (*quoting* Restatement (Second) of Torts § 545A, Comment b (1976)).[20]

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[19] "Reasonable reliance connotes the use of the standard of ordinary and average person." *Vann*, 67 F.3d at 280. The Tenth Circuit has stated:

> This standard of reasonableness places a measure of responsibility upon a creditor to ensure that there exists some basis for relying upon the debtor's representations. Of course, the reasonableness of a creditor's reliance will be evaluated according to the particular facts and circumstances present in a given case.

First Bank v. Mullet (In re Mullet), 817 F.2d 677, 679 (10th Cir. 1987), *abrogated on other grounds*, *Field v. Mans,* 516 U.S. 59 (1995). The "reasonable reliance" standard is an objective one and imposes a "duty to investigate." *Mans*, 516 U.S. at 77.

[20] "Prosser represents common-law authority as rejecting the reasonable person standard here, stating that 'the matter seems to turn upon an individual standard of the plaintiff's own capacity and the knowledge which he has, or which may fairly be charged against him from the facts within his observation in the light of his individual case.' Prosser, supra, § 108, at 717; accord, Prosser & Keeton, § 108, at 751." *Mans*, 516 U.S. at 72.

Therefore, a person may be justified in relying on a representation of fact "'although he might have ascertained the falsity of the representation had he made an investigation.'" *Mans,* 516 U.S. at 70 (*quoting* Restatement (Second) of Torts § 540 (1976)). A person is not required to make an investigation unless "'under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived.'" *Mans,* 516 U.S. at 71 (quoting W. Prosser, Law of Torts § 108, p. 718 (4th ed.1971)).[21]

Promissory Fraud

Some of the representations alleged in the instant case relate to actions to be taken in the future. The District Court for the Northern District of Alabama has held that:

> The only basis upon which one may recover for fraud, where the alleged fraud is predicated on a promise to perform or abstain from some act in the future . . . is when the evidence shows that, at the time . . . the promises of future action or abstention were made, the promisor had no intention of carrying out the promises, but rather had a present intent to deceive.

Wade v. Chase Manhattan Mortgage Corporation, 994 F. Supp. 1369, 1378 (N.D. Ala. 1997) (citing *Robinson v. Allstate Insurance Company*, 399 So. 2d 288 (Ala. 1981)). Further, "[t]he failure to perform, alone, is not evidence of intent not to perform at the time the promise was made . . . ."

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[21] Reasonableness is still relevant, however, and "goes to the probability of actual reliance:" "the greater the distance between the reliance claimed and the limits of the reasonable, the greater the doubt about reliance in fact." *Mans*, 516 U.S. at 76. In other words, "'[t]he plaintiff's conduct must not be so utterly unreasonable, in the light of the information apparent to him, that the law may properly say that his loss is his own responsibility.'" *Vann*, 67 F.3d at 283 (*quoting* W. Page Keeton, Prosser & Keeton on Torts § 108, at 749 (5th ed. 1984)).

Wade, 994 F. Supp. at 1378 (citing *First Bank of Boaz v. Fielder*, 590 So. 2d 893 (Ala. 1991), *overruled on other grounds*, *Life Ins. Co. v. Green*, 719 So. 2d 797 (Ala. 1998)).

Simply put, "the law places a heavier burden in those fraud actions where one attempts to prove fraud based on a misrepresentation relating to an event to occur in the future." *National Sec. Ins. Co. v. Donaldson*, 664 So. 2d 871, 876 (Ala. 1995). In such cases a plaintiff must prove that the debtor did not intend to perform or abstain and intended to deceive the plaintiff at the time the representation was made. *Crowne Investments, Inc. v. Bryant*, 638 So. 2d 873, 877 (Ala. 1994). If such were not the case, every promise to perform in the future, such as a promise to pay a debt at a later date, would constitute nondischargeable fraud if the promise was not fulfilled.

Fraud May be Inferred

Intent to defraud is rarely openly admitted, and often, such intent is not apparent on its face. Therefore, courts must look to the surrounding circumstances to determine whether fraudulent intent should be inferred.[22]

Contentions of the Parties
SouthTrust Bank and McCarthys

SouthTrust Bank contends that Moore misrepresented his intent both to repay the loans and to use the loan proceeds solely to construct houses on the subject lots.[23] The McCarthys contend that Moore did not

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[22] "A finding of fraudulent intent 'may be based on inferences drawn from a course of conduct' or 'inferred from all of the surrounding circumstances.' *See In re Olmstead*, 220 B.R. 986, 994 (Bankr.D.N.D.1998) (citations omitted)." *In re Guadarrama*, 284 B.R. 463, 472 (C.D. Cal. 2002).

[23] SouthTrust points to numerous alleged misrepresentations made by Moore, but the ruling in this case obviates the need to consider other representations.

intend to perform his contract from the beginning.

Moore Contentions

Moore contends that he made no misrepresentation. He was unable to repay the loans because of a recession which affected his business. He had come successfully through other down periods. SouthTrust unreasonably refused to work with him to rehabilitate the loans.[24]

Moore concedes that he was "out of trust" to some extent on all of the construction loans in this proceeding.[25] However, he used the proceeds of the loans in the operation of Moore Construction Company.[26] He kept the business going as long as he could.

In the alternative, Moore contends that SouthTrust was not justified in relying on his representations.

Conclusions of Law

For the reasons that follow, the court concludes that Moore misrepresented his intent both to repay the SouthTrust loans and to use the loan proceeds solely to construct houses on the subject lots. He also misrepresented his intent to perform under the contract with the McCarthys.

When Moore made the second problem loan with SouthTrust in December 1999, Moore did not use any of the proceeds as promised to

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[24] According to Moore, SouthTrust extended him more credit than he deserved and then pulled the rug out from under him.

[25] Moore used the term "out of trust" to indicate that he had not used all of the proceeds of a specific loan to construct a house on the specific lot securing the loan.

[26] Moore's books and records are insufficient to verify this allegation.

construct a house on Lot 21C. Moore neither cleared the lot nor commenced construction. Moore took six draws on the loan totaling $132,600, none of which was used to build on Lot 21C. With the exception of the last draw, the loan was fully funded on February 14, 2000, 2½ months after the loan was made.

By the same date, he had fully drawn the loan for Lot 20C. There is no evidence to show the degree of completion, if any, of the house on Lot 20C in February 2000. However, the house was only 80 to 85% complete in May 2001, almost 2 years after the loan was made.

Moore knew that he was required to use the proceeds of each construction loan solely to construct a specific house on a specific lot.[27] The very process by which loans were made and draws were obtained confirms this knowledge. Moore provided detailed plans of each house in support of each loan application. The amount of each loan was based on the appraised post-construction value of the real property. Moore himself designated the lot to which each draw was applied.

In March 2000 Moore signed a new note refinancing one of the signature loans and obtained the construction loan for Lot 28. At that time, Moore knew that he had received up to $132,600 from SouthTrust Bank for Lot 21C and used the money for unauthorized purposes, leaving SouthTrust with a vacant lot worth only $37,500.

He also knew that he was at least "out of trust" on Lot 20C as well, the initial problem loan. The house was 80 to 85% complete in May 2001. However, 85% of the loan proceeds were drawn by November 1999.

Nevertheless, Moore proceeded and signed a new note refinancing the second signature loan in July 2000. He also fully drew the loan for Lot

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[27] Moore denied knowledge of numerous representations within the loan documents because he denied reading the loan documents. Moore concedes that no one kept him from reading the loan documents.

28 by October 2000. Yet by February 2001, the house consisted merely of a concrete slab with some plumbing pipes attached.

When Moore made the last loan with SouthTrust Bank on January 26, 2001, he knew that he was out of trust on Lot 20C, that Lot 21C remained vacant, that Lot 28 had only a concrete slab, and that he had two signature loans outstanding. He also knew that his state home builder's license had expired.

Despite this knowledge, Moore obtained the construction loan for Lot 4C in January and fully drew the loan by April 20, 2001. Moore did not use the initial draw to obtain a release of the underlying mortgage held by Community Bank & Trust. Moore, as manager of Moore Development Company, L.L.C., would have been responsible for remitting the proceeds to Community Bank & Trust. Therefore, SouthTrust was left holding a second mortgage on the property. By January 2002, the house was only 50% complete.

In March or April 2001, SouthTrust Bank called the two signature loans and terminated its construction loan business with Moore. Moore felt that the bank was cutting off his ability to make money and yet at the same time demanding payment.

Despite his financial condition and the lack of ability to borrow money from SouthTrust, Moore signed the contract with the McCarthys in June 2001. He accepted a deed to their lot and promised a completed home by mid-September. With the exception of the last draw, Moore's loan from Peoples Bank was fully funded within 2 months. By that time, he had only cleared the lot and commenced foundation work. He took the last draw in October when the house was only 40% complete. Moore did no further work on the property.

During the relevant time period, Moore's financial condition was worsening. He was accruing tax obligations as well as mounting debt with at least one of his trade creditors, the Goolsbys. Even before he took out

the loan for the McCarthys, he had defaulted on his federal withholding tax obligations.

Post-transaction Indicia of Fraud

As stated above, intent to defraud is rarely openly admitted, and often, such intent is not apparent on its face. Therefore, courts must look to the surrounding circumstances to determine whether fraudulent intent should be inferred.

Moore's post-transaction dealings with SouthTrust, the McCarthys, Peoples Bank, and Community Bank & Trust also provide probative evidence of his intent to deceive.

When Moore obtained the loan from SouthTrust Bank for Lot 4C in the subdivision development, he did not use the initial draw to obtain a release of the underlying mortgage held by Community Bank & Trust. As stated above, SouthTrust was left holding a second mortgage.

In fact, Moore sold five lots in the subdivision without remitting the proceeds to Community Bank & Trust. Community Bank released the underlying mortgage on three of the lots in an apparent public relations gesture and attempt to avoid a lawsuit by upset purchasers.

In September 2001, Moore provided SouthTrust Bank with a copy of his contract with the Yoakums in an effort to persuade SouthTrust Bank to forbear. However, the Yoakums had withdrawn from the contract by that time.

Moore represented to SouthTrust that he had received $40,000 toward the purchase price of Lot 20 from the Goolsbys. In fact, Moore had not received any cash from the Goolsbys.

Moore misrepresented to SouthTrust that he had an available line of credit from Peoples Bank which he could use to build two speculative

houses.

Moore did not use the proceeds of the loan from Peoples Bank solely to construct a residence on the McCarthy lot. Moore fully drew the loan but completed only 40% of the house. Moore knew that if he defaulted on the loan, the McCarthys could lose their lot through foreclosure. They had transferred the lot to Moore apparently without consideration. The end result is that Moore used their property for collateral to reduce other obligations.

Moore made misrepresentations to Peoples Bank as well. In a ploy to obtain an additional money, Moore represented that the McCarthys had requested the addition of a pool and fence and that the house was otherwise complete. In fact, the house was not complete, and the McCarthys had not asked Moore to build either a pool or a fence.

Upon a review of all of the surrounding circumstances, the court concludes that Moore misrepresented his intent to perform under the loan agreements with SouthTrust and his contract with the McCarthys. He also misrepresented his intent to use the SouthTrust loan proceeds solely to construct a house on the specific lot securing each loan.

Moore Defenses

First, Moore contends that he made no misrepresentation. As explained above, the court concludes that the evidence proves otherwise.

Second, Moore contends that SouthTrust and the McCarthys were not justified in relying on his representations.

Justifiable reliance is not an objective test measured by the standard of the "reasonable man." Rather it involves an examination of the particular plaintiff and the circumstances of the particular case. A person may be justified in relying on a representation without making an investigation to determine whether the representation is true.

As stated above, a person is not required to make an investigation unless "'under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived.'" *Mans,* 516 U.S. at 71 (*quoting* W. Prosser, Law of Torts § 108, p. 718 (4th ed.1971)).

The court concludes for the following reasons that both SouthTrust and the McCarthys were justified in relying on Moore's representations.

First, SouthTrust had a long history of loans made and paid by Moore.[28] In fact, Dykes, who dealt directly with Moore on all of the loans in question, had an even longer history of loans made and paid by Moore. SouthTrust simply had no reason to suspect that Moore was deceiving the bank.

Whether the bank acted "reasonably" in failing to require financial statements and failing to investigate the progress of houses is not the issue. Absent a red flag warning of deception, the bank was not required to make an investigation. The circumstances of each particular case govern.

Moore contends that a look at his financial statements would have dissuaded the bank from lending him money. Moore introduced into evidence balance sheets for Moore Construction Company for the years 1994 through 1998 and 2000. The company had a negative equity for every year except 1994.

However, SouthTrust Bank received only one of these balance sheets.[29] Moore's accountant could not remember which one. He testified that he delivered one balance sheet to SouthTrust during the 1996 to 1998

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[28] As stated above, the 34 loans repaid to SouthTrust totaled about $2.5 million.

[29] The financial statements for the relevant time frame which were in the bank's possession did not reflect a negative equity. SouthTrust offered these in rebuttal to the debtor's testimony.

time frame. He could not be any more specific. Without more, this does not provide proof of a red flag warning SouthTrust of deception in late 1999. Moore's balance sheets do, however, confirm Moore's knowledge of his inability to perform.[30]

The McCarthys were also justified in relying on Moore's representations. The McCarthys were inexperienced in the home building market. They obtained the advice of friends. They selected Moore based on the quality of his work and his reputation as a builder. No red flag appeared to alert the McCarthys that Moore was either untrustworthy or financially unable to complete the contract.

Conclusion

Moore knew that he was financially unable to perform under the SouthTrust loans and the McCarthy contract without obtaining additional capital. He also knew that he was using the construction loan proceeds for unauthorized purposes. He built a house of cards which was dependent on new loans to keep the house afloat.

This became clear to Moore at the time, if not before, he obtained a loan to build a house on Lot 21C and diverted the entire proceeds elsewhere. Not one dime was spent to clear the lot or commence construction. The obtaining or refinancing of credit from that time forward was nothing less than fraudulent. There is no evidence that his financial situation improved. To the contrary, it only continued to worsen.

Moore's debt to SouthTrust Bank and the McCarthys is excepted from discharge under 11 U.S.C. § 523(a)(2)(A). This ruling renders consideration of the claims under 11 U.S.C. § 523(a)(4) and (a)(6) unnecessary.

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[30] Moore testified that a look at his balance sheet at any point in time would have revealed his inability to repay.

A separate order will enter consistent with this opinion.

Done this 29th day of October, 2004.

/s/ Dwight H. Williams, Jr.
United States Bankruptcy Judge

c: Walter F. McArdle, Attorney for SouthTrust Bank
Daniel F. Johnson, Attorney for McCarthy
Steven K. Brackin, Attorney for McCarthy
William Garreth Moore, Defendant